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Impatience Is Not A Virtue

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It seems as though one cannot pick up a newspaper nowadays without reading about one company or another announcing sizable staff layoffs. These cutbacks many times have followed the release of a disappointing earnings report and/or forecast. To save even more money, some companies have begun to discharge relatively senior people. These older employees, of course, tend to be paid more, so their firing saves more dollars than the termination of an equal number of younger, lower-paid workers. The fact that these companies are parting with experienced, highly-skilled workers, whose loss might be keenly felt in the future is, of course, rarely mentioned.

It is not hard to discern the strategy behind these moves. In a world in which being publicly held means managing for the next quarter's earnings report, companies appear to be placing increasing emphasis on impressing investors with swift actions being taken to cut costs and boost profits in order to bolster the price of their stock. There is some irony to this, however, since in many cases the Wall Streeters these firms are trying to curry favor with are none other than the managers of the pension funds for the very same employees who are losing their jobs!

Manufacturers Hanover Economics Department 17/270

Short-Run Obsession

To be sure, one can sympathize with American business's seeming obsession with short-run performance. This is because, with few exceptions, those U.S. companies whose shares are in the hands of the public report their sales and earnings results every three months. These periodic reports are essential, if shareholders—usually absentee owners with little, if any, involvement in running the firm—are to have timely information regarding the state of their investment.

If these investors are satisfied, they will hold onto their stock in the company—if not purchase some more. Needless to say, this will bolster the price of the stock, making not just investors, but the company's managers, themselves, pleased. Since part of many managers' compensation depends on the performance of their company's stock, they obviously have a vested interest in seeing its price rise. Indeed, this is one of the first lessons taught in business schools—to maximize shareholder return, then take care of sueh other corporate constituencies as employees, customers, suppliers and the general public.

As you can imagine, this has produced a system that tends to be geared toward short-term thinking. More than one corporate consultant has observed that executives will not concentrate on the long term until incentives are strong enough to counteract the stimulant of the near term, which, of course, is quarterly profits. In and of itself, this is not all that bad. However, in more than a few instances it results in managers taking action to bolster their companies' stock price in the short term at the expense of sacrificing good long-term returns. To put it another way, for those companies whose shares are listed (and even for many who are privately-held, since, in some cases, they compete with their publicly-held brethren), few actions are undertaken that have no obvious short-run payoff.

Politics Plays A Role

Sometimes efforts to plan for the longer term are impeded by governments at the Federal, state and local level. Congress, for example, tends to enact legislation that changes the rules of the game—rules on which corporate, as well as individual investor decisions were based. The most glaring instance is the investment tax credit, which has been in and out of the tax code a number of times since it was first instituted back in 1962. Even more significant is the Tax Reform Act of 1986, which suddenly and dramatically changed the rules for investing, especially in real estate. Many people think it was the forerunner of the latest national recession.

Elected officials, of course, face even more severe pressures to act for the short term than business people. They must appease their constituents by spending more and/or by cutting taxes before their term of office expires. Since the entire House of Representatives and one-third of the Senate come before the voters ev-

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ery two years, you can see why they need favorable results quickly—even if the economy might suffer in the longer run. Indeed, to a politician, the long run is the day after Election Day!

To be sure, most companies do have people on their staffs engaged in long-range planning. Not surprisingly, most senior managers, if asked, will tell you that they operate under a long-range plan. As a matter of fact, in some industries, long-range planning is essential if they are to grow and prosper. Pharmaceuticals and aerospace, where lead times of ten years or more are necessary before a new product begins to produce a profit, are just two examples.

One can certainly understand the need for long-range planning. To increase productivity and competitiveness, massive investments in research and development, plants and equipment, training and education of the workforce are absolutely essential. While governments invest in infrastructure, companies must invest in new methods of production, distribution and communication. Clearly, these require time before their benefits become apparent.

Unfortunately, we have become too impatient. More than one observer of the American business scene has recalled the statement usually attributed to the great economist, John Maynard Keynes, that "in the long run we're all dead," and urged concentration, instead, on short-run objectives. All well and good, but when the short run becomes as short as the next calendar quarter, and the objective is simply maximizing short-run profits, many companies tend to lose their way. They lose sight of who they are, and where they are going. Writing in the *Harvard Business Review* not long ago, a professor of management at Harvard's Business School said: "Most companies select goals that are too short term... (a) series of short-term goals encourage episodic thinking... (they) also work to back companies into a mode of thinking that is based on forecasts (What do we think is going to happen?), rather than on vision (What do we want to happen?)."

Layoffs Threaten Recovery

This brings us to the U.S. economy's current dilemma. Just when the economy seemed to be emerging from its ninth postwar recession, in the spring of 1991, company after company suddenly became impatient, and began laying off workers. Never mind that virtually all economists were expecting only a mild recovery. As was observed in the June issue of this Report: "...to many, it will be difficult to distinguish between recession and recovery... (t)he muted nature of this recovery contrasts with past rebounds... (r)egardless of when they believe this recovery will get underway, practically all forecasters agree that it will be much slower than average." And the April Economic Report gave the reason for these modest expectations. It pointed out that many of the factors which gave rise to this latest recession are still around.

This impatience now threatens the nascent recovery. For these layoffs have now become widespread, and, in turn, have depressed confidence. To be sure, this is not the first time people have lost their jobs en masse. What is different today, however, is, first, that it is occurring during a period of rising economic activity, and, second, that it is taking place mainly in the service sector of the labor force. The spreading loss of confidence that has developed in the wake of these layoffs in particular stems from the fact that four-fifths of American employees work in the service sector. In other words—almost everybody knows somebody who has lost a job and/or is unable to work in the field for which he or she is qualified.

Vicious Cycle

These layoffs have produced a vicious cycle. As people have lost (or know others who have lost) their jobs, they bcome depressed. Naturally, they curtail their spending, buying only what they must, opting for the least expensive brand in the least expensive outlet. At the same time, they are eschewing such big-ticket, postponable items as cars, houses and household furnishings. Naturally, this produces disappointing sales and earnings—leading to yet another round of layoffs, and so on.

Welcome to the corporate version of musical chairs. Not only are companies looking mainly at short-term results, they are trying to improve their fortunes at the expense of others, who, of course, are returning the favor. Since no one can order this process to halt, what can be done to stop this, before it aborts the fledgling recovery, and pushes the U.S. economy down into another, even deeper, recession?

Don't look to monetary policy to be of much assistance. The Federal Reserve has cut short-

term interest rates in half over the past two years and not only has this failed to prevent a recession—it hasn't led to the rise in borrowing necessary to produce a vigorous upturn. In today's low-confidence environment, the Fed could push interest rates down to zero; if people are afraid of losing their jobs, they are not going to borrow to buy the big-ticket items that drive the economy. For its part, business won't borrow, either, if it sees only dim prospects for sales. Those who do try to borrow are many times unable to do so, as the banks, hobbled by loan losses, unusually strict examination and capital standards, ration their loans.

This could be the 1990s version of the 1930s "liquidity trap," a theory that was also advanced by Keynes, as justification for the need for fiscal stimulus in times like these. As Keynes pointed out, you can pull on a string, but you cannot push on it. In other words—tight money can cool off an overheated economy, but easier money alone may not necessarily do the job of reviving it.

Time For Fiscal Stimulus

It seems fairly obvious that we need fiscal stimulus. Specifically, the government must assume the role of employer of last resort. We have a crying need to increase public investment in roads, bridges, water and sewer systems. Our crumbling infrastructure demands no less. More than one observer of the business scene has pointed out how such a policy could simultaneously address the twin problems of lack of confidence and depressed spending. Anytime an unemployed person finds a job, that person naturally feels better. And every dollar that person earns in his or her new job will be spent and then some, as deferred needs are addressed.

It does not take a rocket scientist to see how such a program could have tremendous ripple effects—enough to jump-start the economy and put the recovery into second gear. For although this would begin as a public program, most of the money spent would flow through the private sector, since Washington does not make steel, cement or wire cables. Thus many businesses would get an immediate lift, in the form of an increase in orders. They, in turn, would have to hire people to fill these orders, who would have more to spend, and so forth. While we are at it, let's be sure to extend the period of time the unemployed can receive jobless benefits; this will boost these people's confidence, too.

But spending is only one blade of the fiscal shears. Tax cuts are necessary as well, in order to inject purchasing power into the hands of the vast majority of people who would not be immediately helped by this program of infrastructure spending. First of all, cut those Social Security taxes—the biggest tax the average household pays. Restore the deductibility of interest and taxes for individuals and you might encourage additional borrowing and spending.

Repeal the luxury tax. This has turned out to be more harmful to those who build the fancy cars, private planes and yachts than to would-be buyers. Help business overcome its lack of confidence by making it cheaper to invest in people, equipment, and even physical plant. Cut the capital gains tax and restore the investment tax credit. These were the key provisions of the 1986 Tax Act, which, as noted above, hurt the real estate market, so why not go all the way and repeal this Act, thus enhancing the value of many properties?

Help real estate and you help the banks, but to make sure, the bank examiners must be ordered to treat real estate loans more reasonably. Whether they realize it or not, real estate cannot be valued on a daily basis the way stocks and bonds are. And while no banker would argue against the need for more capital, the current requirements should be delayed, in order to enable the banks to lend more to those who need it. The banks should also be allowed to diversify their products and to expand across state lines; this would add to their health, which is plainly necessary for a healthy economy.

Would these fiscal actions undertaken by Washington widen its already-swollen budget deficit? Probably, unless some offsets are found in the shrinking defense budget, or in the entitlement programs. However, this should not be too worrisome at this time. For one thing, the deficit is so large, a few billion dollars more shouldn't make much of a difference to the financial markets. For another, as President Herbert Hoover learned, you shouldn't try to balance the Government's budget when the economy is weak; it only makes things worse—including the deficit. The time to have reduced the budget deficit by spending restraint and/or by tax hikes is past; it will come again once the economy strengthens.

Meanwhile fiscal stimulus is just about all we've got left to jump-start the economy. Let's do it now—and avoid more misery later.

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